United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL 77-7232

UNITED STATES COURT OF APPEALS
FILED
SEP 1 1977
M. DANIEL FUSARO, CLERK
SECOND CIRCUIT

United States Court of Appeals
FOR THE SECOND CIRCUIT

HERBERT FEDERMAN et al.,

Plaintiffs,

against

EMPIRE FIRE AND MARINE INSURANCE COMPANY et al.,

Defendants-Appellees,

and

STUART C. GOLDBERG and JACOB ASCHKENASY,
Additional Defendants on Cross-Claims,

STUART C. GOLDBERG,
Additional Defendant on Cross-Claims, Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

APPELLANT'S BRIEF

THAL & YOUTT
Attorneys for Stuart Goldberg as
Cross and Counterclaimant-Appellant
919 Third Avenue
New York, N.Y. 10022

249 Press of Fremont Payne, Inc., 417 Canal St., N. Y.—966—6570

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES. iii

STATEMENT OF ISSUES PRESENTED FOR REVIEW. 1

NATURE OF THE CASE. 3

FACTS 6

ARGUMENT. 12

I. The order of the court below staying further proceedings indefinitely and directing the parties to litigate in state court was a final appealable order 12

II. Because of the underlying federal securities law questions presented by Goldberg's claims and defenses, federal question jurisdiction exists independently of their ancillary or pendent character. 13

III. The court below did not have discretion under the pendent jurisdiction doctrine to dismiss Goldberg's ancillary counterclaim and cross-claims . . 24

A. Definitions 25

B. United Mine Workers of America v. Gibbs. 27

C. Cases involving ancillary jurisdiction issues 30

D. Relevant policy considerations. 34

Table of Contents Continued

Page

IV. Alternatively, assuming that the doctrine of pendent jurisdiction does apply to this case, the court below abused its discretion in denying jurisdiction over Goldberg's claims 41

A. Special circumstances supporting pendent jurisdiction. 41

B. The insufficiency of the Court's reasons for refusing jurisdiction. 45

1. Fraud 46

2. Breach of Warranty. 48

3. Injurious Involvement 48

V. Because proof of Goldberg's damages will include proof of the fact that Judge MacMahon, in an earlier motion in this litigation, erroneously ruled that Goldberg violated his professional ethics, the court below abused its discretion in refusing to recuse itself and order the case transferred to another judge for trial. 51

A. Denial of the recusal motion is appealable at this time 54

B. Judge MacMahon, by reason of the role which his erroneous ethics decision has played in increasing Goldberg's foreseeable damages, has a "substantial interest" in the litigation. 55

C. Recusal should have been ordered because Judge MacMahon is a "material witness" to relevant trial facts 61

CONCLUSION. 65

APPENDIX OF PRINCIPAL STATUTORY AUTHORITIES . . (A)

Table of Contents Continued

Page

T A B L E O F A U T H O R I T I E S

CASES:

Abounader v. Strohmeyer & Arpe Co., 217 A.D. 43, 215 N.Y.S. 702 (4th Dept. 1926) 50
Birdwell v. Hazelwood School District, 352 F.Supp. 613 (E.D. Mo. 1972) 45
Burrows v. Rhodes, [1899] 1 Q.B. 816, [1895-99] All E. R. Rep. 117. 49
In re Chicago Rapid Transit Co., 200 F.2d 341 (7th Cir. 1952) 54
Collier v. Picard, 237 F.2d 234 (6th Cir. 1956). 54
DePietro v. Hecker, 43 M.2d 630, 251 N.Y.S.2d 704 (Co. Ct. 1964). 48
Dery v. Wyer, 265 F.2d 804 (2d Cir. 1959). 32, 33, 37, 40
Druker v. Sullivan, 458 F.2d 1272 (1st Cir. 1972). . . . 13
Ernst & Ernst v. Hochfelder, 425 U.S. 185, 96 S. Ct. 1375 (1976) 15
Friedgood v. Kline, 67 Misc. 428, 123 N.Y.S. 247 (S. Ct., App. Term 1910). 50
Green v. Murphy, 259 F.2d 591 (3rd Cir. 1958). 55
Habeeb v. Daas, 111 Misc. 437, 181 N.Y.S. 392 (S. Ct. 1920) 49, 50
Halliday v. United States, 380 F.2d 270 (1st Cir. 1967) 62
Hecla Powder Co. v. Sigua Iron Co., 157 N.Y. 437 (1899). 50
Horstein v. General Motors Corp., 391 F.Supp. 1274 (S.D.N.Y. 1975) 49, 51
Idlewild Bon Voyage Liquor Corp. v. Epstein, 289 F.2d 426 (2d Cir. 1961), remanded on other grounds, 370 U.S. 713 (1962) 13
Ivy Broadcasting Co. v. American Telephone & Telegraph Co., 391 F.2d 486 (2d Cir. 1968). 14, 15, 23
Kavit v. A. L. Stamm & Co., 491 F.2d 1176 (2d Cir. 1974). 40, 41, 43, 44
Koufakis v. Carvel, 425 F.2d 892 (2d Cir. 1970). 32
LaVeglia v. Guidice, 278 App. Div. 669, 102 N.Y.S.2d 768 (2d Dept. 1951) 47
Leventhal v. Liberman, 262 N.Y. 209 (1933) 47
McFaddin Express Inc. v. Adley Corp., 346 F.2d 424 (2d Cir. 1965), cert. denied 382 U.S. 1026 (1966) . 14

Table of Contents Continued

Page

TABLE OF AUTHORITIES

Meyerhofer v. Empire Fire and Marine Insurance Co., 497 F.2d 1190 (2d Cir.), cert. denied 419 U.S. 998 (1974) 8
Morrison v. National Broadcasting Co., 24 A.D. 284, 260 N.Y.S.2d 406 (1st Dept. 1965), rev'd 19 N.Y.2d 453, 280 N.Y.S.2d 641 (1967) 49
Morrow v. District of Columbia, 417 F.2d 728 (D.C. Cir. 1969) 26
Moses v. Kinnear, 490 F.2d 21 (9th Cir. 1973) 13
In re Murchison, 349 U.S. 133 (1955). 56, 63
National Conversion Corp. v. Cedar Building Corp., 23 N.Y.2d 621, 298 N.Y.S.2d 499 (1969) 47
Ochs v. Woods, 221 N.Y. 335 (1917). 46
Panico v. United States, 412 F.2d 1151 (2d Cir. 1969) . 62
Pipeliners Local Union No. 798 v. Ellerd, 503 F.2d 1193 (10th Cir. 1974). 34
Public Utilities Comm. v. Pollak, 343 U.S. 451 (1952) . 60
Rosen v. Sugarman, 357 F.2d 794 (2d Cir. 1966). 55
Schwab v. Erie Lackawanna R. Co., 438 F.2d 62 (3rd Cir. 1971). 26, 30-32

SEC v. Management Dynamics, Inc., 515 F.2d 801 (2d Cir. 1975) 20
SEC v. National Student Marketing Corp., Civ. No. 225-72 (D.D.C. filed February 3, 1972) 20
SEC v. Rega, [1975-76 Transfer Binder], Fed.Sec.L.Rep. (CCH) ¶ 95, 222 (S.D.N.Y. 1975). 20
SEC v. Spectrum Ltd., 489 F.2d 535 (2d Cir. 1973) . . . 20
SEC v. Universal Major Industries Corp., 546 F.2d 1044 (2d Cir. 1976) 20
Seidel v. Greenberg, 108 N.J. Super. 248, 260 A.2d 863 (1969) 49
Seneca Nursing Home v. Kansas State Bd. of Social Welfare, 490 F.2d 1324 (10th Cir. 1974), cert. denied 419 U.S. 841 (1975) 43
Skirvin v. Mesta, 141 F.2d 668 (10th Cir. 1944) 54
T. B. Harms Co. v. Eliscu, 339 F.2d 823 (2d Cir. 1964) 14
United Mine Workers of America v. Gibbs, 383 U.S. 715 (1966). 24, 27-30, 31, 33, 34, 37, 39, 41, 43

Table of Contents Continued

Page

TABLE OF AUTHORITIES

United States v. Bryan, 393 F.2d 90 (2d Cir. 1968) . . . 57
United States v. Columbia Broadcasting System, 497 F.2d 107 (5th Cir. 1974) 62
United States v. Halley, 240 F.2d 418 (2d Cir.), cert. denied 353 U.S. 967 (1957) 62, 65
United States v. Hughes, 325 F.2d 789 (2d Cir. 1964) 63
United States v. Quattrone, 149 F.Supp. 240 (D. D.C. 1957) 61
United States v. Valentino, 283 F.2d 634 (2d Cir. 1960) 63
United States v. Zarowitz, 326 F.Supp. 90 (C.D. Cal. 1971) 61
Wilkin v. Dana R. Pickup & Co., 74 M.2d 1025, 347 N.Y.S.2d 122 (S. Ct. 1973) 48
Winters v. Travia, 495 F.2d 839 (2d Cir. 1974). 57
Zeller v. Bogue Elec. Mfg. Corp., 476 F.2d 795 (2d Cir.), cert. denied 414 U.S. 908 (1973). . . . 47

STATUTES AND RULES:

Securities Exchange Act of 1934, 15 U.S.C. § 78j (b). . 16
28 U.S.C. §455. . . . . 52, 53, 55, 56, 61, 64
28 U.S.C. §1291 12
28 U.S.C. §1331 . . . . . 13, 24
Federal Rules of Civil Procedure, Rule 13 . . . . . 33, 34, 38, 39
Federal Rules of Civil Procedure, Rule 14 . . . . . 31, 33, 34, 39
Federal Rules of Evidence Rule 104(a) 64
Federal Rules of Evidence Rule 605. 64
17 C.F.R. §240.10b-5 (1977) 6, 16, 18

Table of Contents Continued

Page

TABLE OF AUTHORITIES

TREATISES:

1A Barron & Holtzoff, Federal Practice & Procedure § 23 26
1A Barron & Holtzoff, Federal Practice & Procedure § 397. 25
Note, 81 Harv. L. Rev. 657 (1968) 26
1 Moore's Federal Practice ¶0.60 [1]. 26
1 Moore's Federal Practice ¶0.90 [3]. 25
9 Moore's Federal Practice ¶110.20[4.-2]. 12
Weinstein Korn & Miller, New York Civil Practice ¶3016.05. 46
Wright, Federal Courts, § 20 (1970) 26
Wright, Federal Courts, § 80 (1970) 25

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 77-7232

HERBERT FEDERMAN, et al.,

Plaintiffs,

-against-

EMPIRE FIRE AND MARINE INSURANCE COMPANY, et al.,

Defendants-Appellees,

and

STUART C. GOLDBERG and JACOB ASCHKENASY,

Additional Defendants on Cross-Claims,

STUART C. GOLDBERG,

Additional Defendant on Cross-Claims-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLANT

STATEMENT OF ISSUES PRESENTED FOR REVIEW

The issues presented on this appeal are:

1. Whether federal question jurisdiction exists with respect to the third party claims, counterclaims and cross-claims at issue in this litigation independent of their

character as pendent or ancillary claims, because they present "pivotal questions" of federal securities law and because distinctive policy questions under the federal securities laws are involved.

2. Whether a federal district court has the discretionary power, as delineated by the doctrine of pendent jurisdiction, to dismiss arguably non-federal, ancillary third party claims, counterclaims, and cross-claims at issue among defendants in a lawsuit, after settlement of the original federal claim between plaintiffs and defendants.

3. If the doctrine of pendent jurisdiction does apply to such ancillary claims, whether, under the circumstances of this case, the Court below abused its discretion in effectively dismissing arguably non-federal third party claims, counterclaims and cross-claims after several years of pre-trial proceedings.

4. Whether the Court below abused its discretion in refusing to disqualify itself, since a prior order which it entered, adjudicating appellant to have violated his professional ethics as an attorney, will of necessity become a part of the proof of damages at trial.

NATURE OF THE CASE

This is an appeal from an opinion of the Court below (the Honorable Lloyd F. MacMahon presiding) dated April 12, 1977 (App. 174a-185a), which effectively terminates this action by suspending all further proceedings:

> ". . . pending the commencement and final determination of an action or actions in state court encompassing all the state claims, cross-claims and counterclaims of the parties alleged in this action" (App. 182a-183a).

It is also an appeal from the denial by the Court below on March 29, 1976, of appellant Stuart Charles Goldberg's (hereafter referred to as "Goldberg") motion for an order of recusal and transfer of the case to another district judge for trial.

Goldberg is a third-party defendant, who is counterclaiming and cross-claiming against other defendants for damages which he suffered when it was falsely made to appear that Goldberg was engaged with the other defendants in certain federal securities law violations which are the subject of the complaint. Plaintiffs' claims against defendants were settled in early 1976.

This action was commenced on May 2, 1973, by the filing of a class action suit for damages under the federal securities laws, in connection with a public offering of securities. A second complaint was later filed on October 23, 1973. (App.6a-15a) The present defendants are the issuer Empire Fire and Marine Insurance Company, certain of its officers and directors (hereafter referred to as the "Empire defendants"), and the issuer's

counsel on the public offering, the former law firm of Sitomer, Sitomer & Porges, along with its partners, Alvin L. Sitomer, Stephen J. Sitomer and Robert E. Porges (hereafter referred to as the "Law Firm defendants").

After the filing of the second complaint on March 28, 1974, the Empire defendants impleaded Goldberg and Jacob Aschkenasy (former associates of the Sitomer law firm) as third-party defendants, alleging professional misconduct and malpractice in connection with the securities offering at issue in the lawsuit. (App. 16a-29a). Goldberg answered the third-party complaint on May 27, 1974, as amended June 16, 1974 (App. 30a-58a). In his answer, he also presented a compulsory counter-claim against the Empire defendants and cross-claims against the Law Firm defendants, including third-party defendants Aschkenasy, alleging that he (Goldberg) had been wrongfully and unwittingly involved in and associated with defendants' wrongful securities fraud, resulting in substantial damages to him (App. 53a-58a).

On August 23, 1973, prior to the filing of the third-party claims, cross-claims and counter-claims, the Court below enjoined Goldberg from communicating with counsel for plaintiffs, which he had previously done in a successful effort to convince plaintiffs that he had nto been involved in the securities fraud conspiracy alleged against the law Firm defendants (App. 67a-80a). In its memorandum (hereafter referred to as the "Ethics Opinion") the Court below ruled that Goldberg had violated Canons 4 and 9 of the A.B.A. Code of Professional Responsibility by disclosing confidential

information and by creating the appearance of impropriety.

On June 10, 1974, this Court reversed the Ethics Opinion of the Court below and exonerated Goldberg of any professional misconduct (App. 81a-87a).

All claims between plaintiffs and defendants have been settled, by Order of Settlement dated January 16, 1976 (App. 88a-108a). There remain only the third-party claims of the Empire defendants against Goldberg and Goldberg's compulsory counterclaims and cross-claims against the Empire defendants and the Law Firm defendants, including Aschkenasy.

On March 5, 1976, Goldberg filed a motion for an order of recusal (App. 109-147a) and disqualification, upon the ground that the Ethics Opinion of the Court below resulted in injuries which were within the scope of foreseeability of the torts pleaded by Goldberg against the defendants. Because the Ethics Opinion would become a matter of proof of damages at trial, Goldberg sought recusal to avoid the appearance of judicial impropriety. The recusal motion was denied without opinion on March 29, 1976.

In early April, 1976, defendants moved to dismiss Goldberg's claims upon grounds of failure to state a claim and untimeliness under State statutes of limitation. The Court below granted these motions on December 3, 1976, with leave to replead. (App. 148a).

On December 22, 1976, Goldberg promptly repleaded in an Amendment to his Amended Answer, setting forth causes of action for fraud, express and implied breaches of warranty of employment, and injurious involvement (App. 149a-173a).

On January 14, 1977, defendants moved to dismiss, this time against the Amendment to the Amended Answer, upon grounds of failure to state a claim and untimeliness under statutes of limitations. On April 12, 1977, the Court below, without ruling on any of the issues presented by the motion to dismiss, determined sua sponte that under the doctrine of pendent jurisdiction, the action, which consisted of state tort law causes of action, should be tried in state court. Accordingly, the Court suspended further proceedings in the federal courts pending "commencement and final determination" of state court actions. (App.182a).

Goldberg's Notice of Appeal was timely filed on May 10, 1977.

FACTS

Unlike the dishearteningly recurring number of cases which solely present issues of professional misconduct or wrongdoing by attorneys, this case arises out of the efforts of Goldberg, a securities attorney, to conform to the highest mandates of professional ethics, federal securities laws, regulations and policies. This action commenced as a 10b-5 shareholder derivative action against Empire, the issuer of a public securities offering, and its former law firm for fraud in failing to disclose a substantial finder's fee. Divulgence of the facts amounting to fraud had earlier resulted when Goldberg, honoring his professional duties as a securities attorney, reported to the S.E.C. that he had discovered material deficiencies in connection with the Empire offering. The issuer impleaded Goldberg, a former associate of the firm,

alleging that whatever securities violations may have occurred were the result of malpractice by the attorneys at the firm. Goldberg counterclaimed against the issuer and the Law Firm defendants, contending that they had improperly involved him in a course of wrongful conduct in violation of the securities laws, which resulted in substantial injury to him. Those injuries include loss of employment opportunities, substantial mental anguish and injury to Goldberg's professional standing. His causes of action sound in fraud, breach of express and implied warranties and injurious involvement.

The original claims between the plaintiffs and defendants have been settled, which settlement was approved by the Court below (App. 88a-108a). There remain only the claim over by the Empire defendants against Goldberg and Goldberg's counterclaims and cross-claims against the Empire defendants and the Law Firm defendants.

Goldberg has been a litigant in this action for over three years, since March, 1974. On April 12, 1977, the Court below ruled that because the underlying federal securities law claims between plaintiffs and defendants had been settled in January, 1976, Goldberg must recommence his claims in a state court. Goldberg appeals from that ruling on this appeal.

He also appeals from an earlier denial by the Court below of his motion seeking that the Court recuse and disqualify itself. That motion was based upon the fact that the Court had earlier made a highly publicized ruling that by communicating with plaintiff's counsel in an effort to avoid being served as a defendant in this lawsuit, Goldberg violated his ethics as

an attorney (App.67a-80a). That ruling was later reversed by this Court on a previous appeal (App.81a-87a), but not before Goldberg suffered substantial injuries as a result of the erroneous ethics opinion. Because Goldberg contends that those injuries proximately flow from the tortious wrongs about which he complains, the erroneous Ethics Opinion will be part of the proof of damages at trial.

The salient facts underlying the substantive claims of this lawsuit were set forth in this Court's opinion reversing the erroneous Ethics Opinion, Meyerhofer v. Empire Fire and Marine Insurance Co., 497 F.2d 1190 (2d Cir.) cert. denied and are recited at length herein:

> Empire Fire and Marine Insurance Company on May 31, 1972, made a public offering of 500,000 shares of its stock prusuant to a registration statement filed with the Securities and Exchange Commission (SEC) on March 28, 1972. The stock was offered at $16 a share Empire's attorney on the issue was the firm of Sitomer, Sitomer & Porges. Stuart Charles Goldberg was an attorney in the firm and had done some work on the issue.
>
> * * *
>
> On May 2, 1973, plaintiffs, on behalf of themselves and all other purchasers of Empire common stock, brought this action alleging that the registration

statement and the prospectus under which the Empire stock had been issued were materially false and misleading. Thereafter, an amended complaint, dated June 5, 1973, was served. The legal theories in both were identical, namely, violations of various sections of the Securities Act of 1933, the Securities Exchange Act of 1934, Rule 10b-5, and common law negligence, fraud and deceit. Damages for all members of the class or rescission were alternatively sought.

The lawsuit was apparently inspired by a Form 10-K which Empire filed with the SEC on or about April 12, 1973. This Form revealed that "The Registration Statement under the Securities Act of 1933 with respect to the public offering of the 500,000 shares of Common Stock did not disclose the proposed $200,000 payment to the law firm as well as certain other features of the compensation arrangements between the Company [Empire] and such law firm [defendant Sitomer, Sitomer and Porges]". Later that month Empire disseminated to its shareholders a proxy statement and annual report making similar disclosures.

The defendants named were Empire, officers and directors of Empire, the Sitomer firm and its three partners, A. L. Sitomer, S. J. Sitomer and R. E. Porges, Faulkner, Dawkins & Sullivan Securities Corp., the managing underwriter, Stuart Charles Goldberg, originally alleged to have been a partner of the Sitomer firm, and certain selling stockholders of Empire shares.

* * *

Goldberg, after his graduation from Law School in 1966, had rather specialized experience in the securities field and had published various books and

treatises on related subjects. He became associated with the Sitomer firm in November 1971. While there Goldberg worked on phases of various registration statements including Empire, although another associate was responsible for the Empire registration statement and prospectus. However, Goldberg expressed concern over what he regarded as excessive fees, the nondisclosure or inadequate disclosure thereof, and the extent to which they might include a "finder's fee", both as to Empire and other issues.

The Empire registration became effective on May 31, 1972. The excessive fee question had not been put to rest in Goldberg's mind because in middle January 1973 it arose in connection with another registration (referred to as "Glacier"). Goldberg had worked on Glacier. Little purpose will be served by detailing the events during the critical period January 18 to 22, 1973, in which Goldberg and the Sitomer partners were debating the fee disclosure problem. In summary Goldberg insisted on a full and complete disclosure of fees in the Empire and Glacier offerings. The Sitomer partners apparently disagreed and Goldberg resigned from the firm on January 22, 1973.

On January 22, 1973, Goldberg appeared before the SEC and placed before it information subsequently embodied in his affidavit dated January 26, 1973.

* * *

This document not only went into extensive detail concerning Gold-

> berg's efforts to cause the Sitomer firm to rectify the nondisclosure with respect to Empire but even more extensive detail concerning how these efforts had been precipitated by counsel for the underwriters having come upon evidence showing that a similar nondisclosure was contemplated with respect to Glacier and their insistence that full corrective measures should be taken. Although Goldberg's description reflected seriously on his employer, the Sitomer firm and, also, in at least some degree, on Glacier, he was clearly in a situation of some urgency. Moreover, before he turned over the affidavit, he consulted both his own attorney and a distinguished practitioner of securities law, and he and Abbey made a joint telephone call to Mr. Sullivan of the SEC. Id. at 1192-93, 1195.

The Court below has sua sponte ruled that because of the settlement of the 10b-5 claims between plaintiffs and defendants, Goldberg must begin again in state courts. Goldberg seeks to try his case in federal court, where he was originally sued, where he was compelled to present his substantive counterclaims, and where he originally interposed his cross-claim. He contends here that federal question jurisdiction independently supports his claims since they involve "pivotal questions" and "distinctive policy" issues of federal securities law (infra Point II). He also contends that discretionary dismissal power under the pendent jurisdiction doctrine should not extend to compulsory counterclaims and other ancillary jurisdiction matters (infra Point III). Alternatively, he contends that the Court below abused its discretion in ordering the case tried in state courts under the pendent jurisdiction doctrine (infra Point IV). Finally, Goldberg contends that the Court below abused its discretion by refusing to disqualify itself (infra Point V).

ARGUMENT

I. THE ORDER OF THE COURT BELOW STAYING FURTHER PROCEEDINGS INDEFINITELY AND DIRECTING THE PARTIES TO LITIGATE IN STATE COURT WAS A FINAL APPEALABLE ORDER.

The Court below did not finally dismiss the action but instead elected to retain jurisdiction in the case and

> ". . . suspend all further proceedings herein pending the commencement and final determination of an action or actions in state court encompassing all the state claims, cross-claims and counterclaims of the parties alleged in this action" (App. 182a-183).

The purpose in so doing was to preserve the federal forum for Goldberg in the event his claim would be held to be time- barred because of the time which elapsed while the case was in federal court (App. 182a).

However, notwithstanding the facial non-finality of the order, it is submitted that for all practical purposes, it terminates the action and is a final appealable order under 28 U. S.C. §1291. Essentially, this very problem is addressed in 9 Moore's Federal Practice ¶110.20[4.-2](p.251):

> "If there is no action pending in a state court and the district court stays the action before it and directs the parties to go to the state court to obtain a ruling as to what the state law is, the stay is appealable as a final order under 28 U.S.C. §1291."

See Idlewild Bon Voyage Liquor Corp. v. Epstein, 289 F.2d 426 (2d Cir. 1961) at 428, remanded on other grounds, 370 U.S. 713 (1962). See also Druker v. Sullivan, 458 F.2d 1272 (1st Cir. 1972); Moses v. Kinnear, 490 F.2d 21 (9th Cir. 1973).

Because, as in Idlewild, the Court's stay renders Goldberg "effectively out of court", his appeal of right at this time is appropriate.

II. BECAUSE OF THE UNDERLYING FEDERAL SECURITIES LAW QUESTIONS PRESENTED BY GOLDBERG'S CLAIMS AND DEFENSES, FEDERAL QUESTION JURISDICTION EXISTS INDEPENDENTLY OF THEIR ANCILLARY OR PENDENT CHARACTER.

The Court below based its sua sponte denial of jurisdiction solely upon the discretionary doctrine of pendent jurisdiction. Goldberg contends, infra, that that determination was erroneous under standards of pendent and ancillary jurisdiction (See Points III and IV). The ruling of the Court below was premised, of course, upon the assumption that but for the pendent jurisdiction doctrine, Goldberg's claims present issues which would only be cognizable in state courts. Before addressing the pendent jurisdiction issues, Goldberg submits that the Court's premise was incorrect since independent federal question jurisdiction under 28 U.S.C. § 1331 exists, sufficient to render any pendent or ancillary analysis moot.

As this Court has interpreted the decisional law on the

dimensions of federal question jurisdiction, a claim "arises under" federal law

> ". . . if and only if the complaint is for a remedy expressly granted by the [federal] Act . . . or asserts a claim requiring construction of the Act . . . or, at the very least and perhaps more doubtfully, presents a case where a distinctive policy of the Act requires that federal principles control the disposition of the claim." T.B. Harms Co. v. Eliscu, 339 F.2d 823 (2d Cir. 1964) at 828.

As set forth in McFaddin Express Inc. v. Adley Corp., 346 F.2d 424 (2d Cir. 1965), cert. denied 382 U.S. 1026 (1966), the test is:

> ". . . whether the complaint is for a remedy expressly granted by an act of Congress or otherwise 'inferred' from federal law, or whether a properly pleaded 'state created' claim itself presents a 'pivotal question of federal law', for example because an act of Congress must be construed or " 'federal common law' govern[s] some disputed aspect "of the claim." Id. at 426.

In Ivy Broadcasting Co. v. American Telephone & Telegraph Co., 391 F.2d 486 (2d Cir. 1968), this Court held that:

> "A case may 'arise under' federal law even though the claim is created by state law, if the complaint discloses a need for the interpretation of an act of Congress. Smith v. Kansas City Title & Trust Co., 255 U.S. 180, 41 S. Ct. 243, 65 L.Ed. 577 (1921); see DeSylva v.

> Ballentine, 351 U.S. 570, 76 S. Ct. 974, 100 L.Ed. 1415 (1956). We believe that a cause of action similarly 'arises under' federal law if the dispositive issues stated in the complaint require the application of federal common law, a conclusion which we have intimated in prior decisions. See Port Authority Bondholders Protective Committee v. Port of New York Authority, 387 F.2d 259 (2 Cir., Nov. 19, 1967); McFaddin Express, Inc. v. Adley Corp., 2 Cir., 346 F.2d 424, 426-427 (1965), cert. denied, 382 U.S. 1026, 86 S. Ct. 643, 15 L.Ed.2d 539 (1966); cf. T.B. Harms Co. v. Eliscu, 2 Cir., 339 F. 2d 823, 828 (1964). The word 'laws' in § 1331 should be construed to include laws created by federal judicial decisions as well as by congressional legislation. Id. at 492.

The Court in Ivy Broadcasting further elaborated that:

> "Our holding that the district court has jurisdiction under §1331 of plaintiff's actions in the present case does not imply that federal jurisdiction extends to any case which involves some reference to federal law; that federal law furnishes a necessary ingredient of a claim is insufficient as a basis for federal jurisdiction, unless the claim presents an issue requiring construction of an Act of Congress or unless a distinctive policy of an Act of Congress requires that federal principles control the disposition of the claim".
>
> Id. at 493.

Goldberg's claims in this litigation are all premised upon the federal securities law violations which were asserted originally by the plaintiffs in this action. The existence of a pervasive federal securities policy hardly requires citation before this Court. The Supreme Court in Ernst & Ernst v.

Hochfelder, 425 U.S. 185, 96 S. Ct. 1375 (1976) has recently summarized the scope of federal securities regulation as including the protection of investors against fraud, the promotion of "ethical standards of honesty and fair dealing" and the imposition of regular reporting requirements. 96 S. Ct. at 1381-82. (Emphasis added.)

Concededly, Goldberg has not asserted a claim for a remedy "expressly granted" or "otherwise inferred" from the federal securities laws. Goldberg lacks standing to recover damages under the implied right of action recognized and delineated by the Courts, especially that contained in Section 10(b) and Rule 10b-5 thereunder of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (b) and 17 C.F.R. § 240.10b-5 (1977).

His claims are therefore set forth in terms of common law tort theory. However, in all other respects, Goldberg's claims in this action require proof of the same facts and establishment of the same legal principles as if he were a plaintiff in a 10b-5 fraud action. Because of this, he asserts that his claims arise under federal law independently of their jurisdictional status as ancillary or pendent claims. For purposes of this jurisdictional evaluation, a brief summary of the federal nature of Goldberg's claims is set forth below.

Goldberg's claims center upon the activities in 1971 and 1972 of the members of his former law firm employer, together with their client Empire in preparing a public offering

of Empire common stock. Specifically, he claims that the law firm and Empire defendants conspired to conceal, in violation of their reporting and disclosure obligations under the Securities Laws, a quarter-million dollar contingent finder's fee and 200 share stock option (Amendment to Complaint ¶¶ 50a-55a;App. 153a-157a). In this respect, the salient allegation of Goldberg's amended claims is that the law firm defendants and the Empire defendants concealed the true facts of the public offering transaction from Goldberg

> ". . . as part of their joint device and scheme to violate the Securities laws and criminal statutes of the United States by concealing [the finder's fee arrangement and the finder's stock option] and thereby avoiding the necessity of disclosing such a finder's fee [and finder's stock] as such in the registration statement and the public offering prospectus." (App.156a and 157a ¶¶ 54a and 55a).

All of Goldberg's causes of action center upon the proof of a federal securities fraud in connection with the public offering of Empire stock. (See also Amendment to Answer ¶¶ 64a, 71a) He must prove this fraud before he proceeds to establish the aspects of liability which he claims extend to him and entitle him to relief.

It should also be stressed that the third-party claims of the Empire defendants against Goldberg for malpractice (App.24a-29a) also call for an evaluation and

interpretation of the securities laws. Since it is alleged that whatever violations of the securities laws occurred as originally alleged by plaintiffs were the result of professional incompetence on the part of, inter alia, Goldberg, a defense against these claims will also call for the complex determination of federal securities law issues.

Up to this point, the issues in this lawsuit are virtually identical to the issues in a private claim for securities fraud damages (indeed, they are essentially the same issues as those presented by the plaintiffs in the original main claim in this action, which was settled in January, 1976) and in an S.E.C. enforcement proceeding or injunction action (indeed, they are essentially the same issues as those presented by the S.E.C. in an injunction action against the law firm defendants in the Southern District, Index No. 73 Civ. 4508, terminated On May 13, 1976 by consent injunction and administrative disbarment of defendants Alvin Lester Sitomer and Stephen Joel Sitomer from further practice before the S.E.C.).

The violations of the federal securities laws which Goldberg asserts branch off into state tort law claims only because Goldberg does not possess the necessary privity or transactional nexus to the securities market to enable him to set forth a cognizable 10b-5 claim for civil damages. However, the Courts will be called upon to make the same determinations of federal securities law as if Goldberg were a civil plaintiff or as if he represented the Securities Exchange Commission before determining the state law theories

asserting that Goldberg has been defrauded, that warranties were breached, or that he was tortiously and injuriously involved in a wrongful scheme. Not only is a federal court best equipped to interpret the federal securities laws, but it is submitted that the congressional interest in comprehensively and uniformly regulating the securities industry can best be served if federal question jurisdiction is accepted by this Court, so that a federal adjudication of the underlying securities law violations can be finally rendered.

Goldberg also contends that "distinctive" federal securities law policy requires that federal principles control the disposition of his claims for the additional reason that the heart of this lawsuit concerns Goldberg's role as a federal securities lawyer and the duties which he perceived and performed in connection with reporting the Empire securities fraud.

As the complaint alleges, when he was unable to persuade the law firm defendants to report their failure to disclose the Empire finder's fee, Goldberg:

> ". . . himself took such steps as were necessary, proper and legally and ethically mandated by securities laws and regulations, criminal statutes, and by professional ethics, by appearing at the offices of the S.E.C. and making disclosure, inter alia, of the Empire finder's fee information." (App. 159a; ¶59a)

Among the elements of damage which he has pleaded are the contentions that he was subjected to a "malicious campaign of

vilification" by the law firm defendants as a consequence of his action in reporting the fraud. (App. 161 a; ¶60a(iii)), that he became one of the subjects of the S.E.C. investigation (which resulted in damage to him although he was at the end fully exonerated) (App. 162 a; ¶60a(v)), and that he became the subject of a bar association investigation (again resulting in damage to him although he was fully exonerated) into the question of whether his reporting the fraud to the S.E.C. violated the Code of Professional Responsibility (App.162a; ¶60a(vi)).

Moreover, defense of the third party claim against Goldberg by Empire that the securities law violations were the result of Goldberg's alleged incompetence will present issues as to the performance of one's reasonable duties as a federal securities lawyer.

The issues with respect to all of the above items involve significant questions of federal securities policy as it affects the duties of lawyers and the protection of the rights of lawyers who perform their duties. It is virtually self-evident that the interest of the Securities Exchange Commission and the federal courts in administering this policy is substantial, if not exclusive. See SEC v. Spectrum Ltd., 489 F.2d 535 (2d Cir. 1973); SEC v. Universal Major Industries Corp. 546 F.2d 1044 (2d Cir. 1976); SEC v. Management Dynamics, Inc., 515 F.2d 801 (2d Cir. 1975); SEC v. Rega, [1975-76 Transfer Binder], Fed.Sec. L.Rep. (CCH) ¶ 95, 222 (S.D. N.Y. 1975), See also the complaint in SEC v. National Student Marketing Corp., Civ. No. 225-72 (D. D.C.

filed February 3, 1972), and recently settled by the entry of a consent injunction.

Indeed a more precise measure of the federal interest in these issues can be found in the body of the amicus curiae brief filed October 23, 1973 by the Commission in this Court (Index No. 73-2340) in the appeal of the decision which had erroneously found Goldberg to have violated his ethical duties. In describing its interest in the matter at that time, the brief explained:

> "As stated in its preamble, the Securities Act of 1933, 15 U.S. C. 77a, et seq., was enacted "to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent fraud in the sale thereof . . . ." The Supreme Court explained in Securities and Exchange Commission v. Ralston Purina, 346 U.S. 119, 124 (1953) that full disclosure protects investors because it makes available 'information thought necessary to informed investment decisions.' It is essential to the administration of the federal securities laws that the professionals entrusted with the implementation of the policies embodied therein not tolerate any conduct by their clients which clearly operates as a fraud on the public investor. As the Commission recently noted in permanently disqualifying an attorney from practicing before it:
>
> 'Members of this Commission have pointed out time and time again that the task of enforcing the securities laws rests in overwhelming measure on the bar's shoulders. These were statements of what all who are versed

in the practicalities of securities law know to be a truism, i. e., that this Commission with its small staff, limited resources, and onerous tasks is peculiarly dependent on the probity and the diligence of the professionals who practice before it. Very little of a securities lawyer's work is adversary in character. He doesn't work in courtrooms where the pressure of vigilant adversaries and alert judges check him. He works in his office where he prepares prospectuses, proxy statements, opinions of counsel, and other documents that we, our staff, the financaial community and the investing public must take on faith. This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the disclosure documents that they produce.' (In the Matter of Emanuel Fields, Securities Act Release No. 5404 (June 18, 1973), note 20, petition for review pending, C.A.D.C. No. 73-1722.)

In this connection, it is important that attorneys who discover material deficiencies of a fraudulent character in a registration statement, such as in the instant case, be free to report this information to the Commission.

* * *

Yet, as Mr. Goldberg's experience demonstrates, a likely and forseeable consequence of reporting fraudlent conduct to the Commission is the public disclosure of that fraudulent conduct, and a private civil action precipitated by the public disclosure. Where the attorney who has disclosed the fraud is associated with the fraudulent conduct or representations, he is

> likely to be made a defendant in the private action. In other words to come to the Commission is to invite being sued, . . . he must participate in the litigation and bear the attendant burden and expense, including the clouding of his professional reputation, in order to establish his non-culpability. Such a likely and forseeable consequence of reporting fraudulent conduct to the Commission will surely discourage attorneys from fulfilling their professional obligations, and thus will frustrate the disclosure philosophy of the federal securities laws."

Because of the significant federal interest in properly administering federal policy with respect to the securities bar and because of the inevitability that numerous questions closely bearing upon this policy will confront a Court upon the trial of this action, this is clearly a case presenting federal question jurisdiction.

In summary, it is apparent that Goldberg's claims "arise under" federal law, as the courts have interpreted 28 U.S.C. §1331. He has set forth a "properly pleaded 'state created' claim [which] presents a 'pivotal question of federal law.'" An act of Congress must be construed, and the "federal common law" relating to liability for federal securities fraud governs numerous "key disputed aspect[s]" of the claim. Moreover, in light of the dominant presence of federal securities regulation interests in the substantive issues presented by Goldberg's claims, it is also clear, in the words of the Court in Ivy Broadcasting, supra, that:

> ". . . a distinctive policy of an

> Act of Congress requires that federal principles control the disposition of the claim." 391 F.2d at 493.

For these reasons, should the Court be inclined to reject Goldberg's arguments that the Court below erred in refusing to exercise ancillary or pendent jurisdiction, this Court should hold that independent federal jurisdictional grounds support Goldberg's claims under 28 U.S.C. §1331.

III. THE COURT BELOW DID NOT HAVE DISCRETION UNDER THE PENDENT JURISDICTION DOCTRINE TO DISMISS GOLDBERG'S ANCILLARY COUNTERCLAIM AND CROSS-CLAIMS

The Court below applied the doctrine of pendent jurisdiction, as set forth in the Supreme Court's opinion in United Mine Workers of America v. Gibbs, 383 U.S. 715 (1966) to the procedural facts of this case. Concluding that pursuant to the doctrine as enunciated in Gibbs and several of its Second Circuit progeny, continued exercise of jurisdiction over Goldberg's state claims after settlement of the concedely valid federal claim was a matter within his discretion, the Court below purported to exercise its discretion by denying a federal forum to Goldberg (App. 177a-183a).

On this appeal, Goldberg contends that the flexible discretionary power of a court to retain jurisdiction over a party's non-federal claims after dismissal of such party's non-frivolous federal claims, as set forth in Gibbs, should not be extended to provide the same discretionary power over non-federal compulsory counterclaims, cross-claims, and third party claims. As Goldberg will contend, reasons supporting a distinction in

treatment of pendent claims, on the one hand, and ancillary counter-claims and cross-claims on the other hand, are based largely upon differences in both policy and doctrinal considerations between the two jurisdictional categories.

A. Definitions

At the outset, it should be noted that one of the problems confronting courts and commentators is a confusion in the use of the terms "ancillary" and "pendent". It is generally agreed that the term "ancillary" covers the following situation described in 1 Moore's Federal Practice ¶0.90[3]:

> "When a federal court has jurisdiction over the main cause of action, it also has jurisdiction over any proceedings ancillary to that action, regardless of the money involved, the citizenship of the parties, or the existence of a federal question in the ancillary suit . . . ."
>
> * * *
>
> "Since cross-claims, compulsory counterclaims, and third party claims arise out of the main cause of action, they are ancillary to that action, and if there is federal jurisdiction over the main action, there is jurisdiction over these ancillary claims . . . ."

See also 1A Barron & Holtzoff, Federal Practice & Procedure § 397. Wright, Federal Courts, § 80 at 353 (1970).

On occasion, the term "pendent" has concededly been used interchangeably with the term "ancillary". As one Court has noted, the terms have ". . . not been forged into separate

vessels with different contents." Schwab v. Erie Lackawanna R. Co., 438 F.2d 62 (3rd Cir. 1971) at 70n.18. See also 1 Moore's Federal Practice ¶0.60[1].

On the other hand, Professor Wright supplies a distinction:

> " 'Pendent jurisdiction' as the term has been used in this section, refers only to the joinder of state and federal claims, though the concept is not unrelated to the doctrine of ancillary jurisdiction applicable in diversity litigation. The pendent jurisdiction concept applies only where the same parties are involved on the state and federal claims." Wright, Federal Courts, § 20, at 65 (1970)

See also 1A Barron & Holtzoff, Federal Practice & Procedure § 23:

> "There is, however, another aspect of ancillary jurisdiction, sufficiently distinctive that it is frequently referred to by a different name, 'pendent jurisdiction'. This deals with the joinder by plaintiff of multiple claims, of which one raises a federal question."

It has also been said that ". . . pendent jurisdiction is a species of ancillary jurisdiction." Note, 81 Harv. L. Rev. 657, n.1 (1968).

At least one court has referred in dicta to the doctrine of pendent jurisdiction as a concept apart from ancillary jurisdiction, albeit an "analogous practice" to or "an extension of the notion of" the doctrine of ancillary jurisdiction. Morrow v. District of Columbia, 417 F.2d 728, 738 and n. 38 (D.C. Cir. 1969) (Wright, J.). In his opinion, Judge Wright

set forth that pendent jurisdiction concepts apply ". . . when a party lists federal and non-federal grounds for a cause of action".

For purposes of clarity in the body of this brief, the term "pendent jurisdiction" shall be used to refer to the jurisdictional foundation for non-federal claims which are asserted by a party who has also asserted non-frivolous, substantial claims based upon some independent federal jurisdictional base. And, "ancillary jurisdiction" shall refer to the jurisdictional foundation for all other non-federal claims, such as counterclaims, cross-claims, and third-party claims, which are made by a party who has come under the jurisdiction of the federal courts by reason of the assertion of a federal claim by another party.

B. United Mine Workers of America v. Gibbs

Gibbs involved a damage action by a mine superintendent against a union for violation of the Taft-Hartley Act. Gibbs also asserted a cause of action based upon the tort law of the State of Tennessee. A verdict in favor of Gibbs on both federal and state causes of action was rendered. However, the federal claim was later dismissed on a post-trial motion. In addressing the threshold question whether jurisdiction over the state claim existed in the federal court, the Supreme Court set forth that:

> "Pendent jurisdiction, in the sense of judicial power, exists whenever there is a claim 'arising under [the] Constitution, the Laws of the United States, and treaties made, or which shall be made,

> under their Authority * * *, 'U.S. Const., Art. III, § 2, and the relationship between that claim and the state claim permits the conclusion that the entire action before the court comprises but one constitutional 'case'. The federal claim must have substance sufficient to confer subject matter jurisdiction on the court . . . The state and federal claims must derive from a common nucleus of operative fact. But if, considered without regard to their federal or state character a plaintiff's claims are such that he would ordinarily be expected to try them all in one judicial proceeding, then, assuming substantiality of the federal issues, there is power in federal courts to hear the whole." 383 U.S. at 725.

The Court proceeded to declare that the power conferred by the doctrine of pendent jurisdiction need not be exercised in every case. The doctrine's:

> ". . . justification lies in considerations of judicial economy, convenience, and fairness to litigants; if these are not present a federal court should hesitate to exercise jurisdiction over state claims, even though bound to apply state law to them . . . . " Id. at 726.

There followed a discussion of factors for consideration which have generally been adopted as criteria to govern the exercise of pendent jurisdiction discretion:

> ". . . needless decisions of state law should be avoided both as a matter of comity and to promote justice between the parties, by procuring for them a surer-footed reading of

> applicable law. Certainly, if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well. Similarly, if it appears that the state issues substantially predominate, whether in terms of proof, of the scope of the issues raised, or of the comprehensiveness of the remedy sought, the state claims may be dismissed without prejudice and left for resolution to state tribunals. There may, on the other hand, be situations in which the state claim is so closely tied to questions of federal policy that the argument for exercise of pendent jurisdiction is particularly strong. In the present case, for example, the allowable scope of the state claim implicates the federal doctrine of pre-emption; while this interrelationship does not create statutory federal question jurisdiction, Louisville & N.R. Co. v. Mottley, 211 U.S. 149, 29 S.Ct. 42, 53 L.Ed. 126, its existence is relevant to the exercise of discretion. Finally, there may be reasons independent of jurisdictional considerations, such as the likelihood of jury confusion in treating divergent legal theories of relief, that would justify separating state and federal claims for trial, Fed. Rule Civ.Proc. 42(b). If so, jurisdiction should ordinarily be refused. Id. at 726-27.

Applying these criteria to the facts in Gibbs, the court upheld the jurisdiction over the non-federal cause of action on pendent jurisdiction grounds, concluding that it was closely related to the Taft-Hartley issue and that intricate questions were presented involving pre-emption principles for which federal courts are "particularly appropriate bodies".

As can be seen from the facts in Gibbs and the Court's

description of pendent jurisdiction, the Court was addressing itself only to the situation in which federal and state claims are asserted by the same claimant in the same action. It was not addressing the situation which confronts the Court here: the maintenance of allegedly non-federal claims in compulsory counterclaims and cross-claims where the federal basis of jurisdiction existed between the original plaintiff and defendant. Because, as will be seen, significantly different policy considerations from those which confronted the Court in Gibbs are presented in this appeal, it is respectfully submitted that the discretionary power delineated in Gibbs should not govern the ancillary jurisdiction status of Goldberg's claim. Instead, this Court should declare that there is no such discretion to dismiss Goldberg's claims, and reverse and remand for trial.

C. Cases involving ancillary jurisdiction issues.

Several cases have addressed the problem of dismissal of ancillary claims as presenting distinct issues from cases involving the doctrine of pendent jurisdiction. The leading case is Schwab v. Erie Lackawanna R. Co., 438 F.2d 62 (3rd Cir. 1971). Invoking the doctrine of pendent jurisdiction, the district court had dismissed the defendant's third-party claims, which lacked independent federal jurisdictional status, against impleaded defendants. The Third Circuit reversed, holding that the district court possessed no discretion to

dismiss non-pendent, ancillary claims. Quoting extensively from the leading federal procedure treatises, the Court determined that a claim cognizable under FRCP Rule 14 (as well as related claims asserted under FRCP Rule 18): ". . . is ancillary to, and thus jurisdictionally dependent upon, the jurisdiction of the original plaintiff's main claim" Id. at 67.

In evaluating the district court's dismissal, under Gibbs standards, of the ancillary claims, the Court acknowledged that:

> "To be sure, a district court has a certain discretion in deciding how to dispose of multiple claims in a single action."

However, it immediately admonished:

> "But that discretion is not unlimited and cannot be enlarged simply by characterizing a claim as 'pendent' and invoking the broad language of . . . [Gibbs] which arose in a different context and involved additional considerations." Id. at 71.

Accordingly, the Court concluded that:

> ". . . a proper exercise of the district court's discretion was limited to the power to order a separate trial of the claim in accordance with Rule 42(b)". Id. at 72.

In so holding, the Court noted that its:

> ". . . research has uncovered no case applying the Gibbs doctrine to a situation in which ancillary jurisdiction had already attached, and the multiple claims were contained in secondary pleadings in the form of a compulsory counter-

claim, a cross-claim, or a third-party complaint". Id. at 7, n.20.

In Koufakis v. Carvel, 425 F.2d 892 (2d Cir. 1970) this Court remanded state law counterclaims for re-trial in federal court, even though the main claims, which were based upon federal jurisdiction, had been settled:

> "Despite the possible absence of a trademark issue on remand, the case should remain in federal court. It is well settled that the jurisdiction of the federal courts, once acquired in cases similar to the present one, does not necessarily fail due to subsequent actions by the parties such as amendment of their pleadings to drop all claims of trademark infringement . . . . We see no point in applying a different rule in the present case, where the trademark issues may now be out of the case because of a settlement agreed upon by the parties after trial and after discussion with the trial judge." Id. at 900.

In Dery v. Wyer, 265 F.2d 804 (2d Cir. 1959), the main (F.E.L.A.) claim was settled before trial, leaving a third party complaint involving non-federal grounds in litigation. After trial, at the request of this Court, the question of jurisdiction over the third party complaint was briefed and argued. In deciding the issue, this Court applied the general proposition that:

> ". . . when federal jurisdiction over the subject matter of the main action once attaches, the court has ancillary jurisdiction to decide a third-party dispute growing out of the same core of facts and hence within the scope of the Rule even though the dispute, separately considered, is lacking in the attributes of federal jurisdiction." Id. at 807.

It therefore held that third party claims under Rule 14, like compulsory counterclaims under Rule 13, ". . . may rest on ancillary jurisdiction without need for an independent ground of federal jurisdiction". Id. at 807-08.

The Court did note that:

> "A rule of procedure, however convenient and salutary it may be, is without efficacy to extend the jurisdiction of a court. See Hurn v. Oursler, 289 U.S. 238, 53 S.Ct. 586, 77 L.Ed. 1148; Fed. Rules Civ. Prac., Rule 82. But Rule 14 does not extend jurisdiction. It merely sanctions an impleader procedure which rests upon the broad conception of a claim as comprising a set of facts giving rise to rights flowing both to and from a defendant. For solution of the incidental jurisdiction problems which often attend utilization of the procedure, the concept of ancillary jurisdiction, which long antedated the Federal Rules, may often be drawn upon." Id. at 808.

The Court in Dery also held that

> ". . . the ancillary jurisdiction over the third-party complaint was not lost when the main cause of action was settled. Generally, in a diversity action, if jurisdictional prerequisites are satisfied when the suit is begun, subsequent events will not work an ouster of jurisdiction."

Although the Court in Dery pointedly did not decide the issue of whether discretion exists to dismiss ancillary claims (265 F.2d at 809), it is clear from an evaluation of the cited authorities that this was not the type of discretion later enunciated in Gibbs, but instead was the discretion which FRCP Rule 14 then accorded to district courts in permitting third-

party claims to be impleaded.

And in Pipeliners Local Union No. 798 v. Ellerd, 503 F.2d 1193 (10th Cir. 1974), the Court held with respect to the status of a compulsory counterclaim after voluntary dismissal of the complaint, that ". . . the court has ancillary jurisdiction to decide it even though the plaintiff's claim be dismissed" Id. at 1199. Here again, it is noteworthy that in so holding, the Court did not engage in any evaluation whatsoever of the discretionary factors detailed in Gibbs and applied to the review of pendent jurisdiction issues.

D. Relevant policy considerations.

Ancillary jurisdiction interests vary distinctly from those underlying pendent jurisdiction evaluations. In pendent jurisdiction, the pendent claimant has chosen the forum and the theory of federal jurisdiction. He had a choice to abandon what on hindsight at least has turned out to be an invalid federal claim and to file in state court. And since the pendent claimant has presented both federal and state claims, it is the extremely rare case in which only the federal claim would be settled before judgment on the merits, leaving state claims to be pursued.

By contrast, a party making a compulsory counter-claim under Rule 13 or a cross-claim under Rule 14 has not chosen the forum. He had no effective alternative to open his case in state court. He has not chosen a federal jurisdiction theory

which is later ruled insufficient. And it is far more likely that the original claim giving rise to federal jurisdiction will be settled between at least some of the parties short of judgment, leaving non-federal cross-claims and possibly counter-claims in litigation.

These differences give rise to several distinguishing considerations between pendent and ancillary jurisdiction claims. First, while it may be fair to place the risk of the failure of federal jurisdiction upon the party who conceives it, it is distinctly unfair to shift that burden to a party who had no part in either its formulation or its ultimate rejection as a substantive theory. And while it may be fair to accord an unwilling ancillary claimant an option out of the federal forum upon the failure of federal jurisdiction, it would be distinctly unfair to force him out once he resolved to make the most of his predicament and once he took substantial positive steps to prepare his case for trial in the federal courts. Certainly the factors which an ancillary claimant cites in support of the inequity of returning to state court should be given substantial weight in his favor (substantially more weight than would be given to the same factors cited by a pendent claimant who has chosen initially to roll the dice in the federal forum on his own federal theory).

Beyond the private equities between the interests of pendent vs. ancillary parties are distinguishing policy features

which affect the civil litigation justice system in general. Pre-judgment settlements are favored and encouraged not only as a frequently superior social means of resolving disputes but also as a practical expedient for assisting to reduce the dockets and work load of overburdened courts. Pendent jurisdiction issues generally have a neutral effect upon settlement encouragement policy. Settlement is neither necessarily encouraged nor discouraged by a judicial policy favoring dismissal of pendent claims after dismissal on the merits of federal jurisdiction claims. This is simply because a claimant who has not settled his federal claims before disposition on the merits is not likely to settle his surviving pendent claims. On the other hand, it is far more likely that federal claims would be settled between some or all parties in an ancillary jurisdiction case, leaving non-federal cross-claims and possibly compulsory counter-claims between some of the parties intact. Indeed, exactly that happened in the instant case.

Accordingly, it can be seen that a policy favoring the liberal dismissal of ancillary claims in such a situation could and in many cases would tend to discourage the pre-judgment settlement of civilly litigated disputes. After four years or more of pre-trial litigation, a defendant who might otherwise be desirous of settling all of his federal claims with a plaintiff could well decide not to do so if it would force him to begin anew in state courts his substantial non-federal cross-claims or counterclaims against other defendants. The result

would be that settlement of all issues between plaintiff and one, some or all defendants could be thwarted in the face of an anticipated dismissal of ancillary claims.

Similar considerations of policy were discussed by the Court in Dery v. Wyer, supra, in its opinion upholding ancillary jurisdictional support for non-federal third-party claims after settlement of the main federal claim. Although policy was there discussed in connection with a somewhat different issue (i.e., whether ancillary jurisdiction exists at all, as opposed to whether, if it exists it should be subject to the discretionary factors set forth in Gibbs), it is submitted that the same policy matters support the distinction from Gibbs which Goldberg asserts before this court:

> "Considerations of policy, as well as the foregoing analogies, accord with our conclusion. If the main claim and the third-party claim are tried together and a decision or a settlement in favor of the plaintiff is announced on the main claim in advance of a decision of the third-party claim, to hold that the determination of the main claim ousted the court of jurisdiction over the ancillary claim would in many cases entail a serious waste of effort by both the judge and the litigants. The natural tendency would be to discourage settlements. And the same considerations, though perhaps to a lesser degree, would tend to discourage adjudications on motions and settlements in advance of trial. Confusion

> would result from such doctrine not only as to the timing but also as to the nature of the event causing loss of the ancillary jurisdiction. If the jurisdictional loss were held not to flow from a settlement of the main claim after trial, can it consistently be held that a settlement thereof at some pre-trial stage will operate to terminate jurisdiction over the third-party claim? Is an out-of-court agreement of settlement an operative jurisdictional factor, or must the agreement be translated into a judicial order to dismiss the claim as moot or to enforce the settlement? Not infrequently, if ancillary jurisdiction were thus subject to defeasance, the third-party claim might be time-barred although, to be sure, that seems not to be an immediate hazard in this case. In short, a rule that ancillary jurisdiction of a third-party claim terminates on a determination of the main claim will seriously impair the utility of the Rule, breed confusion and generate many sterile jurisdictional disputes." Id. at 808-09.

It is also noteworthy that no rule commands that pendent state claims be asserted by a federal plaintiff. By contrast, a federal defendant is required to set forth as a counter-claim:

> "...any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the Court cannot acquire jurisdiction." FRCP Rule 13(a).

Goldberg did just as he was required in counter-claiming against the Empire defendants. It would indeed be incongruous if a party were required by the procedural rules to assert a claim which a court would be free in its discretion under Gibbs to dismiss. It would also be incongruous to allow such discretionary dismissal principles to deprive a defendant of the permissive rights to cross-claim against co-parties and to implead third parties which are expressly conferred by FRCP Rule 13(g) and (h) and Rule 14(a).

Viewed doctrinally, a substantial distinction can be seen between a pendent claim after dismissal on the merits of a federal claim and an ancillary claim after pre-judgment settlement of the federal claims. After dismissal, the base of federal jurisdiction in the pendent case, though not frivolous and not insubstantial, has been determined not to exist, as a matter of law. Although the Courts in the pendent jurisdiction cases have determined that federal jurisdiction is involved and can discretionarily continue, the strength of such fundamental underlying jurisdiction is notably less than that which originally existed in the case at bar. Here there has been no judicial declaration that the federal substantive theory was insufficient as a matter of law. Indeed, what was originally involved was an adequately pleaded claim of federal securities fraud. Thus the underpinning of federal jurisdiction in this case, as distinct from the typical

pendent situation, is solid. (See, e.g., Kavit v. A. L. Stamm & Co., 491 F.2d 1176, 1179 (2d Cir. 1974): ". . . the flimsy nature of federal claims may call for dismissal of state claims.")

Perhaps this difference, though unarticulated in other cases, provides the reason why this Court in ancillary jurisdiction cases, has carefully emphasized that:

> ". . . the sufficiency of jurisdiction should be determined once and for all at the threshold and if found to be present then should continue until final disposition of the action." Dery v. Wyer, 265 F.2d 804, 808 (2d Cir. 1959).

This is significantly different from the evaluations in pendent cases which focus not upon the outset but upon the status of the interests of the parties at the time the federal claims are dismissed in determining whether discretion should be exercised to continue jurisdiction beyond that point. It is submitted that the distinction should be that in ancillary jurisdiction cases, once the outset is evaluated to determine that federal jurisdiction was indeed originally established, no discretion should exist (as it does in pendent cases) to dismiss the ancillary claims. Such a distinction would also serve the settlement encouragement policy discussed above and would properly do justice to the private equities which are elaborated herein.

IV. ALTERNATIVELY, ASSUMING THAT THE DOCTRINE OF PENDENT JURISDICTION DOES APPLY TO THIS CASE, THE COURT BELOW ABUSED ITS DISCRETION IN DENYING JURISDICTION OVER GOLDBERG'S CLAIMS.

A. Special circumstances supporting pendent jurisdiction.

Even assuming that pendent jurisdiction standards properly apply to Goldberg's claims, the Court below abused its discretion in denying federal jurisdiction. Although under Gibbs, once federal claims are dismissed,

> ". . . the court should refrain from exercising pendent jurisdiction absent exceptional circumstances,"

Kavit v. A. L. Stamm & Co., 491 F.2d 1176, 1180 ((2d Cir. 1974) exceptional circumstances do in fact exist in this case to conclusively justify the retention of jurisdiction.

The Court in Kavit, supra, carefully delineated in a footnote the nature of the special circumstances to which it was referring:

> "Such circumstances might be found when the defendant fails to call the court's attention to the weakness of the federal claim before the court has invested a substantial amount of time in the case, see, e.g. A. H. Emery Co. v. Marcan Products Corp., 389 F.2d 11, 19-21 (2d Cir.) cert. denied 393 U.S. 835 . . .; when the pendent claim significantly invokes

> questions of federal policy, as in Gibbs itself, see also Almenares v. Wyman, 453 F.2d at 1085, or when dismissal of the pendent claims would otherwise sharply clash with the directive in Gibbs that pendent jurisdiction serve the ends of 'judicial economy, convenience and fairness to litigants.' 383 U.S. at 726." 491 F.2d at 1180, n.4.

As will be seen, this case meets all of these "special circumstances" criteria.

First, the defendants never called the pendent jurisdiction issue to the attention of the court, and Goldberg has invested a substantial amount of time in the case. Present counsel for Goldberg was retained in early 1976, soon after the settlement of the plaintiffs' claims, for the purpose of preparing for an imminent trial. Defendants soon moved to dismiss Goldberg's claims, and lengthy motion papers were filed by both sides. The pendent jurisdiction issue was never raised. Upon submission of the motion in April,1976, the Court advised the parties to be prepared to go to trial upon ten days' notice. The Court rendered its decision granting the motion to dismiss with leave to replead in December, 1976. Goldberg promptly repleaded. Defendants promptly moved to dismiss -- again without raising the pendent jurisdiction issue. The Court took the motion under advisement and rendered its pendent jurisdiction decision sua sponte on April 12, 1977.

More importantly, as is set forth in greater detail above at Point II, Goldberg's claims "significantly invoke questions of federal policy. . ." (Kavit, supra; See also Gibbs, supra) under the securities laws. Even if this Court declines to hold that federal securities law questions are "pivotal" thereby invoking "arising under" jurisdiction (Point II, supra), such issues are sufficiently central and essential to Goldberg's claims to render it hightly inappropriate to dismiss the case on pendent jurisdiction grounds. See Seneca Nursing Home v. Kansas State Bd. of Social Welfare, 490 F.2d 1324, 1329 (10th Cir. 1974), cert. denied 419 U.S. 841 (1975) (upholding exercise of pendent jurisdiction ". . . in view of the complexity of the intertwined federal issues"). To paraphase the Court in Gibbs, the federal court is a "particularly appropriate body" to determine the securities law issues presented in this case (See Point II, supra).

Finally, it is submitted that to relegate Goldberg to seek his remedies in the state courts at this late date would result in substantial judicial diseconomy, inconvenience, and unfairness. He has honored his obligation to be ready for imminent trial by retaining trial counsel and by preparing for trial. This case was filed in 1973. If it remains in the federal system, it will be tried soon. If it is relegated to the state courts, it will be a new case and will begin at the bottom of the trial priority list. Moreover, it can easily be anticipated that the defendants will seek to dismiss for failure to state a claim. Not only will such a motion result in the expenditure of counsel's time in submitting new papers,

but it is likely that the case will go to the New York Court of Appeals on the dismissal issue before it is reached for trial. By the time it does, (possibly three or four years from now) any factual sources for proof at trial of events which took place in 1971 and 1972 will be extremely stale. On this point it is particularly noteworthy that already the delays to date have seriously impaired Goldberg's case. A scheduled trial witness for Goldberg would have been former S.E.C. Chairman, Manuel F. Cohen, who would have testified that Goldberg originally consulted him concerning the Empire and related frauds, that he advised Goldberg to resign from the Sitomer law firm immediately, and that he advised Goldberg to report the matter to the S.E.C. Unfortunately, Mr. Cohen has recently passed away.

All of this is not to mention the fact that in state court, questions of discovery will be fully re-opened. Goldberg's federal deposition consumes 1316 pages. The Court below had ordered an end to discovery as of February, 1976. However, in the state court, the potential for further unnecessary and repetitious depositions and/or lengthy motions for protective orders is wide open.

In short, Goldberg is a man of modest means and resources. To force him to expose himself to a newly commenced action and to a renewed procedural morass is likely to sound the practical death knell to his cause of action. To do so manifestly would fail to:

> ". . . serve the ends of judicial economy, convenience and fairness . . . ." (Kavit, supra at 1180 n.4).

Accordingly, under the standards of special circumstances set forth by this Court, the Court below should not have denied pendent jurisdiction to Goldberg's claims, and it was an abuse of discretion to do so.

B. The insufficiency of the Court's reasons for refusing jurisdiction.

On the other hand, the Court's principal reasons for declining jurisdiction were its determinations that the case presents "novel and complex problems" of state law, that it involves "extremely complicated and unprecedented questions" of state law, that it would establish precedents in a ". . . relatively uncharted area of state law," and that the state law issues, in light of their novelty and complexity, predominate over federal issues (App.180a,181a). In response, Goldberg respectfully submits that so long as the special circumstances exist as set forth above in support of the exercise of jurisdiction, it is simply not a sufficient reason to decline jurisdiction solely because of the difficulties involved in construing and disposing of novel issues of state law. See Birdwell v. Hazelwood School District, 352 F.Supp. 613 (E.D. Mo. 1972) (". . . difficulties in construing a new . . . [state] statute without benefit of state case law on point is not a sufficient basis upon which to decline to exercise jurisdiction.").

Moreover, Goldberg submits that the assessment by the Court below of the complexity and novelty of state law issues is significantly overstated. For purposes of evaluating this assessment, the substantive claims are briefly analyzed below.

1. Fraud

Goldberg sets forth a claim in fraud (Second Cause of Action, App. 165a-167a) that tracks the hornbook elements of the tort. He claims that the defendants knowingly made materially false representations to him concerning the status of a finder's fee and stock option agreement in connection with the Empire public offering, in order to deceive Goldberg, consistent with their plan to conceal rather than disclose the finder's fee and stock option agreement in connection with the public offering, that Goldberg relied upon the false representations in performing legal services concerning the public offering, believing the representations to be true, and that he suffered damages in consequence of his reliance. Very little, if anything novel or unique under New York State law is involved in this cause of action. See Ochs v. Woods, 221 N.Y. 335 (1917); Weinstein Korn & Miller, New York Civil Practice ¶ 3016.05.

Similarly, the other fraud count (Fourth Cause of Action, App. 171a) alleges that Goldberg was fraudulently induced to take employment with the Sitomer firm upon representations that they were competent and ethical attorneys and observed and abided by the Code of Professional Responsibility and applicable securities regulations. Again, nothing novel in law is presented by this hornbook format of fraud allegations.

With regard to the measure of fraud damages, again Goldberg is not sailing on uncharted waters. Although defendants have erroneously argued that under New York law a plaintiff in a fraud action is limited to the recovery of out-of-pocket damages, ample authority supports the awarding of consequential damages such as those sought by Goldberg. Leventhal v. Liberman, 262 N.Y. 209 (1933), a case involving fraudulent inducement to marry, squarely holds that:

> "The pecuniary loss is by no means the limit of damage in such a case as this. The plaintiff, beside any direct pecuniary loss, may have the jury consider as bearing upon the question of damage the fact that she has changed her status as a single woman, has suffered humiliation, disgrace and mental anguish, and that she has also been deprived of the society, comfort, and attention of a well man. What these damages are or should be, must rest very largely in the discretion of the jury, but these are elements which they may consider in arriving at the amount." 262 N.Y. at 214.

See also, National Conversion Corp. v. Cedar Building Corp., 23 N.Y.2d 621, 298 N.Y.S.2d 499 (1969) (awarding tenant consequential damages for cost of installing and removing equipment from business shut down as result of landlord's fraud was within trial court's discretion); La Veglia v. Guidice, 278 App.Div. 669, 102 N.Y.S.2d 768 (2d Dept. 1951) (buyer entitled to prospective profits from business lost through sellers' fraud); Zeller v. Bogue Elec. Mfg. Corp., 476 F.2d 795 (2d Cir.), cert. denied, 414 U.S. 908 (1973) (consequential damages recoverable for fraud under the Securities Acts,

and "[w]e would see nothing wrong in a principle varying the required degree of certainty somewhat inversely with the depth of the fraud." 476 F.2d at 803n.11).

2. Breach of Warranty

Goldberg has alleged (Third Cause of Action, App.167a-171a) that the law firm defendants, his employers, breached express and implied warranties that they were competent and ethical attorneys, which warranties were made at the time Goldberg went to work for the firm. Such breaches, he contends, resulted in the damages which he sets forth in the Amendment to the Answer. Again, although there is no direct precedent involving a suit by an attorney against his former employer, nothing novel or unique to the law of warranty is presented by the claim which Goldberg makes. See, e.g., De Pietro v. Hecker, 43 M.2d 630, 251 N.Y.S.2d 704 (Co. Ct. 1964) (breach of warranty by former client against attorney where attorney warranted specific result) Cf. Wilkin v. Dana R. Pickup & Co., 74 M.2d 1025, 347 N.Y.S.2d 122 (S. Ct. 1973) (accountants).

3. Injurious Involvement

In the final analysis, the novelty and uniqueness which really concerned the Court below relates only to Goldberg's first cause of action -- injurious involvement. (App. 149a-165a). However, although this tort is admittedly a non-conventional tort, as will be seen, it is by no means a case of first impression under New York law.

The injurious involvement claim is based upon the proposition that corrupt wrongdoers who deliberately and knowingly, involve an innocent party in their wrongful scheme should be

liable for damages which proximately result when the wrongdoing is exposed and the innocent party suffers injury from inferences of guilt. The tort of injurious involvement has been recognized by the courts of New York. Morrison v. National Broadcasting Co., 24 A.D.2d 284, 260 N.Y.S.2d 406 (1st Dept. 1965), rev'd 19 N.Y.2d 453, 280 N.Y.S.2d 641 (1967) (quiz show contestant involved in rigged game). See also Habeeb v. Daas, 111 Misc. 437, 181 N.Y.S. 392 (S. Ct. 1920). It has also been recognized by the New Jersey state courts. Seidel v. Greenberg, 108 N.J. Super. 248, 260 A.2d 863 (1969) (employee involved in employer's arson scheme). And indeed, a variation of it has been recognized and treated by the Federal District Court for the Southern District, applying New York law in Horstein v. General Motors Corp., 391 F.Supp. 1274 (S.D. N.Y. 1975) (consumer involved in apparent car theft by manufacturer's negligent practices concerning vehicle identification numbers).

The roots of the tort of injurious involvement extend far deeper than the recent authorities just cited. In Burrows v. Rhodes, [1899] 1 QB. 816, [1895-99] All E.R. Rep. 117, an armed servant of the British South Africa Co. was induced by the company's director and officer to take part in an illegal invasion of the Transvaal, with resultant injuries including the loss of his leg. The defendants had told Burrows the expedition was lawful, and he was thus "unwittingly and innocently made to commit what the law has said shall be called a crime." 1 Q.B. at 827, All E.R. Rep. at 123.

Earlier New York cases in which the above proposed elements of injurious involvement were present include: Hecla Powder Co. v. Sigua Iron Co., 157 N.Y. 437 (1899) (dynamite shipped to purchaser without required permits for landing in Cuba, resulting in fines levied on purchaser for receiving "contraband"); Friedgood v. Kline, 67 Misc. 428, 123 N.Y.S. 247 (S. Ct., App. Term 1910) (wholesaler delivered adulterated vinegar to retailer, who suffered fine and costs as a result); Abounader v. Strohmeyer & Arpe Co., 217 A.D. 43, 215 N.Y.S. 702 (4th Dept. 1926) (retailer sustained fines and loss of reputation when manufacturer sold him short-weighted salad oil); Habeeb v. Daas, 111 Misc. 437, 181 N.Y.S. 392 (S. Ct. 1920) (gratuitous bailment of stolen goods from thief to unwitting friend, resulting in prosecution of friend).

It is thus apparent that even the injurious involvement claim is solidly based in recognized authority. This is not to assert that it is controlled on all fours by any one of the cases cited above. Nor is it to deny that certain aspects of the present claim require a somewhat complex evaluation of New York law. Goldberg merely contends that in deciding such claims, a federal court would not be writing New York law on a clean slate. Ample New York authorities exist to provide guidance to the Court.

In perspective, the injurious involvement claim is but one of four causes of action, the other three being set forth in conventional tort framework. And, in light of all of the special circumstances supporting the retention of jurisdiction, the Court should not be permitted to avoid an adjudica-

tion on the merits solely because some complex issues are involved. See e.g., Horstein v. General Motors Corp., supra.

V. BECAUSE PROOF OF GOLDBERG'S DAMAGES WILL INCLUDE PROOF OF THE FACT THAT JUDGE MacMAHON, IN AN EARLIER MOTION IN THIS LITIGATION, ERRONEOUSLY RULED THAT GOLDBERG VIOLATED HIS PROFESSIONAL ETHICS, THE COURT BELOW ABUSED ITS DISCRETION IN REFUSING TO RECUSE ITSELF AND ORDER THE CASE TRANSFERRED TO ANOTHER JUDGE FOR TRIAL.

The nub of Goldberg's claim for damages is his contention that as a direct and proximate result of the wrongful acts of defendants in concealing the finder's fee arrangements and failing to report them in connection with the Empire Public offering, he has suffered substantial injuries, including injury to his reputation and psychological harm (App. 160a-161a). Among other damage theories which he shall present at trial is the claim that as a proximate result of the defendants' wrongful acts, Goldberg was held, in an opinion by the Court below in a preliminary proceeding, to have violated his ethical duties of confidentiality under the Code of Professional Responsibility. The opinion, which enjoined Goldberg from further violations of the Code of Professional Responsibility was later reversed by this Court in an opinion which clearly held that "there are no violations" of ethical canons by Goldberg (App. 87a). However, the reversal did not come until long after the media had reported Goldberg to be an ethics violator. Such media reports included the New York Law Journal, the same newspaper

which Goldberg had previously served for two years as Securities Law columnist (August 31, 1973, p.1: "Ethics Violations Found in Securities Offering" (30 references to Goldberg's name) (App. 116a-117a, 164a). The immediate result of this story was Goldberg's removal from the paper's list of regular columnists. The proof at trial will demonstrate that the opinion by the Court below not only further damaged Goldberg's reputation, but also served to exacerbate substantially the mental suffering which he was experiencing as a result of the case and for which he was then receiving psychiatric treatment.

Goldberg is thus confronted with the unhappy situation in which an erroneous ruling by the Court below has become a cog in the proximate sequence of events stemming from the wrongs committed by defendants and resulting ultimately in the injuries which Goldberg has suffered. In short, Goldberg contends that the ethics ruling was a foreseeable consequence of the securities-law-violation conspiracy, which resulted in compensable injuries to him. Because of the Court's direct involvement in the factual claims of the case, Goldberg moved, on March 1, 1976, for an order of recusal (App. 109a), which motion was denied in an oral ruling without opinion on March 29, 1976 (App. 4a). On this appeal, Goldberg contends that Judge MacMahon's denial of the recusal motion constituted an abuse of discretion and a violation of 28 U.S.C. § 455, and he asks that this Court reverse and order the case transferred to another judge for trial below.

The then applicable statute, 28 U.S.C. § 455, provided that:

> "Any justice or judge of the United States shall disqualify himself in any case in which he has a substantial interest, has been of counsel, is or has been a material witness, or is so related to or connected with any party or his attorney as to render it improper, in his opinion, for him to sit on the trial, appeal, or other proceeding therein.*/

Goldberg contends that by reason of Judge MacMahon's rather unique position in the proximate chain of facts, Judge MacMahon should have disqualified himself because

1) his nexus to the facts of the case renders him substantially interested in it, such that his participation in the trial would frustrate and defeat the "appearance of justice";

2) he is a material witness; and

3) his presiding over the trial of the case would render the proceedings unfair as a matter of constitutional due process.

For purposes of clarity, several threshold disclaimers are in order. It is essential to stress at the outset that the recusal

---

*/ The new and substantially changed version of 28 U.S.C. § 455 is inapplicable here since it only applies to actions commenced after its effective date, December 5, 1974.

issues here presented do not suggest or intimate that Judge MacMahon is, has been, or will in the future be consciously biased or prejudiced against Goldberg. Nothing in the record supports such a conclusion. Nor is the presentation or analysis of these issues intended to suggest that Judge MacMahon should bear any of the legal or moral responsibility for the exacerbation of Goldberg's injuries. Goldberg merely contends that under all of the cisrumstances, it would be improper, unfair and injurious to the appearance of justice for Judge MacMahon to preside at a trial of this action, and his failure to recuse himself constituted a reversible abuse of discretion.

A. Denial of the recusal motion is appealable at this time.

Although an order denying recusal is not independently appealable standing alone, the courts have repeatedly ruled that such a denial may be: ". . . reviewed on appeal from an interlocutory order which is appealable or from the final judgment in the case." Skirvin v. Mesta, 141 F.2d 668 (10th Cir. 1944) at 671. See also Collier v. Picard, 237 F.2d 234 (6th Cir. 1956); In re Chicago Rapid Transit Co., 200 F.2d 341 (7th Cir. 1952). In this case the appealable order is the Court's order, denying pendent jurisdiction and directing that the case be tried in New York State courts. (See Point I, above). Consistent with the above authorities, Goldberg seeks review of the denial of recusal in connection with his appeal as of right of the jurisdiction order.

Indeed, a ruling that the recusal order is not presently reviewable would defeat the important interest in proper judicial administration, relied upon by this Court in Rosen v. Sugarman, 357 F.2d 794 (2d Cir. 1966), in securing prompt and timely review and a final ruling on the issue whether a judge's refusal to disqualify himself was "clearly wrongful". Id. at 797. See also Green v. Murphy, 259 F.2d 591 (3rd Cir. 1958). Although the Court in Rosen held that a denial of disqualification, standing alone, was not independently appealable as of right, it went on to hold that a writ of mandamus would lie in the proper case. Since mandamus is available, it would be a virtual futility for the Court to deny review by appeal in connection with plaintiff's appeal of the jurisdiction issue. If need be, Goldberg shall consistent with Rosen, perfect an appropriate petition for writ of mandamus as an alternative procedural vehicle to obtain review by this Court.

B. Judge MacMahon, by reason of the role which his erroneous ethics decision has played in increasing Goldberg's foreseeable damages, has a "substantial interest" in the litigation.

The applicable version of 28 U.S.C. § 455 requires that a judge ". . . disqualify himself in any case in which he has a substantial interest . . . ." As will be shown, "interest" in the context here used is not limited to a pecuniary interest in the parties, the litigation or the attorneys. Goldberg

contends on this appeal that Judge MacMahon, because of the position of his erroneous ethics decision in the chain of proximate cause, has a substantial interest in the case, within the meaning of 28 U.S.C. § 455 and should have disqualified himself.

The Supreme Court has had occasion to discuss in detail the significance of the "interest" concept as a disqualifier in recusal situations. In re Murchison, 349 U.S. 133 (1955), held that a judge who had presided in "one man" grand jury proceedings should have been disqualified from adjudicating contempt charges arising out of those proceedings: The Court observed that:

> "A fair trial in a fair tribunal is a basic requirement of due process. Fairness of course requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness. To this end, no man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome. That interest cannot be defined with precision. Circumstances and relationships must be considered. This Court has said, however, that 'Every procedure which would offer a possible temptation to the average man as a judge * * * not to hold the balance nice, clear, and true between the State and the accused denies the latter due process of law.' Tumey v. Ohio, 273 U.S. 510, 532. . . . Such a stringent rule may sometimes bar trial by judges who have no actual bias and who would do their very best to weigh the scales of justice equally between contending parties. But to perform its high function in the best way 'justice must satisfy the appearance of justice.' Offutt v. United States, 348 U.S. 11, 14 . . . ." Id. at 136.

Central to the statutory purpose of disqualifying judges who have "substantial interests" in litigation is the desire to prevent even the appearance of impropriety or unfairness. In United States v. Bryan, 393 F.2d 90 (2d Cir. 1968), this Court, in commenting upon the Government's petition for a writ of mandamus prohibiting retrial of a criminal case before the original trial judge, observed per curiam that such a procedure would be contrary to the prevailing practice in the Southern District. As the Court noted, in a multi-judge district:

> ". . . the practice of retrial before a different judge is salutary and in the public interest, especially as it minimizes even a suspicion of partiality."

In Winters v. Travia, 495 F.2d 839 (2d Cir. 1974), this Court again recorded its sensitivity to the appearances of justice in recommending, on remand after a mandamus petition was granted setting aside an order pursuant to FRCP Rule 35 for a physical and mental examination, that the district judge

> ". . . will give very serious consideration to whether transfer [to a judge other than the one who originally dismissed plaintiff's claim] would not serve the appearance of justice and thereby help assure its existence." 495 F.2d at 842

The Court based its recommendation in part upon the well-known comment of Farrer Herschell that:

> "Important as it was that people should get justice, it was even

more important that they should be made to feel and see that they were getting it."

2 J. Atlay
Victorian Chancellors
460 (1908)

Of course, on this appeal, Goldberg does not contend that the "appearance of justice" should mandate recusal or transfer in every instance of remand after an adverse determination by the Court below. However, he does contend for the reasons discussed at length herein, that special circumstances warrant the ordering of such relief prior to the trial of his substantive claims below.

Certainly in this case, a variety of the classic appearances of a bias or prejudice can be seen. Goldberg claims and shall attempt to prove that he suffered substantial psychological and reputation injuries as a result of the erroneous ethics opinion. The natural and expected tendency on the part of the author of that opinion would be to deny and disclaim responsibility (albeit moral and not legal responsibility) for such injuries. In such a position, the author of the opinion would be expected and would appear to be predisposed against Goldberg's claims.

But, something more than and different from the mere appearance of bias against Goldberg's claim is presented by this case. If Judge MacMahon presides at the trial of the case, the witnesses who testify that the ethics opinion was rendered, that it was erroneous, and that it resulted in the reputation injury and mental suffering for which Goldberg seeks to recover all will be required to confront Judge MacMahon himself. Goldberg contends

that the potential chilling or inhibiting effect of Judge MacMahon's dominant position in the trial upon such witnesses will be substantial.

Still another potential for procedural unfairness, this time from the standpoint of the jury, is presented by the presence of Judge MacMahon as the trial judge. If the members of the jury learn, as they probably shall, that the opinion was rendered by the trial judge, they may well preceive that an award of damages for such injuries would constitute a moral judgment of liability against the trial judge himself. As we have emphasized, this is, of course, not Goldberg's theory and would constitute a legally erroneous perception. However, the danger that such a perception would arise is increased substantially by the dominant presence of the trial judge. In such event, the jury would find itself upon the horns of a dilemma. In spite of their findings of fact from the record as to causation and damages, they may feel compelled by reason of the trial judge's authoritative role in the proceedings, to resolve that dilemma in their verdict in what they percieve to be the judge's favor. Such a result would inure to Goldberg's obvious and impermissible disadvantage.

The potential for subconscious influence is an additional factor in evaluating the "interest" of a judge in pending litigation. As Mr. Justice Frankfurter expressed it, even though on the whole, judges are capable of laying aside their ". . . private views in discharging their judicial functions:"

> ". . . it is also true that reason cannot control the subconscious influence of feelings of which it is unaware. When there is ground for believing that such unconscious feelings may operate in the ultimate judgment, or may not unfairly lead others to believe they are operating, judges recuse themselves. They do not sit in judgment. They do this for a variety of reasons. The guiding consideration is that the administration of justice should reasonably appear to be disinterested as well as be so in fact." Public Utilities Comm. v. Pollak, 343 U.S. 451 (1952) at 466-67.

In this case the trial court will no doubt be called upon to rule on numerous issues arising out of the erroneous ethics decision. Such issues may include threshold legal questions of foreseeability and causation of injuries, questions as to the admissibility and sufficiency of evidence pertaining to damages, and questions as to the propriety of proffered jury instructions pertaining to the ethics decision injuries. If Judge MacMahon is to conduct the trial, his rulings on the questions of legal sufficiency, evidence and jury instructions could be subconsciously affected by his own, naturally human desire to avoid any responsibility for the exacerbation of Goldberg's injuries by reason of the erroneous ethics decision. Again, even if he could avoid such a subconscious tendency, the judge could not avoid the possible appearance that subconscious influences may have been operating if he were to rule against Goldberg on any legal issues involving the ethics decision issue. To avoid such a risk or the appearance of that risk, the only proper remedy would have been for Judge MacMahon to recuse himself. Under the circumstances, Goldberg contends

that it was an abuse of discretion not to do so.

Again here, abuse of discretion is highlighted by the fact that the Court below, without the benefit of argument and without the submission of briefs in opposition, rendered a brief ruling denying recusal without setting forth his reasoning in an oral or written opinion. (App. 4a). The facts presented on the motion are extremely rare. As is set forth herein, the ramifications, their impact upon a fair tribunal, and their potential for subconscious influence, present substantial matters for thorough reflection and consideration. The fact that such reflection and consideration and the Court's reasoning in ruling against recusal were nowhere set down upon the record tends to support the conclusion that they may not have been seriously considered. If indeed they were not, then it cannot be said that counterveiling factors have been properly weighed against Goldberg in the Court's sound discretion. As a result, the unrecognized danger of unfairness and potential subconscious influence are that much greater. Compare United States v. Quattrone, 149 F.Supp. 240 (D. D.C. 1957); United States v. Zarowitz, 326 F.Supp. 90 (C.D. Cal. 1971).

C. Recusal should have been ordered because Judge MacMahon is a "material witness" to relevant trial facts.

28 U.S.C. § 455 expressly required that a judge:

> ". . . disqualify himself in any case in which he . . . is or has been a material witness. . . . "

The cases clearly support this requirement.

In United States v. Columbia Broadcasting System, 497 F.2d 107 (5th Cir. 1974), the Court reversed a criminal contempt conviction for violation of certain verbal, unrecorded orders of the trial court banning publication of courtroom sketches. In so holding, the Court noted that it was:

> ". . . faced with the unusual setting of a judge trying a case in which he was a principal actor in the factual issues to be determined. Essential to the proof of the prosecutions case were acts committed by the judge himself. . . ."
>
> The guarantee to the defendant of a totally fair and impartial tribunal, and the protection of the integrity and dignity of the judicial process from any hint or appearance of bias is the palladium of our judicial system." Id. at 109.

In Halliday v. United States, 380 F.2d 270 (1st Cir. 1967) the Court ruled that a judge who presided at a guilty plea should recuse himself in a subsequent 2255 proceeding challenging the sufficiency of the plea under FRCP Rule 11. In so holding, the Court took pains to point out that it was not disparaging the potential for objectivity of district judges and explained that:

> "rather, we feel that they should be relieved of what we deem the unnecessary burden of deciding when they can properly redetermine factual issues in this particular area. Moreover, it is not unimportant that judicial decision-making not only be fair, but that it so appear to all eyes." 380 F.2d at 274.

See also, Panico v. United States, 412 F.2d 1151 (2d Cir. 1969) at 1156; United States v. Halley, 240 F.2d 418 (2d Cir.), cert. denied 353 U.S. 967 (1957)("Where the judge

may be a material witness he himself should not hear the case but ought to disqualify himself"); United States v. Valentino, 283 F.2d 634 (2d Cir. 1960). And, see United States v. Hughes, 325 F.2d 789 (2d Cir. 1964)(dicta)(holding that disqualification is required if a judge is a witness, but if he merely might be a witness, disqualification is "merely a rule of good practice". In such event, failure to disqualify is not an abuse of discretion where there are offsetting "considerations of efficient judicial administration which favor his presiding").

Similarly, in In re Murchison, 349 U.S. 133 (1955), the Supreme Court held that a judge who presided at "one man grand jury" proceedings could not later preside at contempt trials which arose out of the earlier proceedings. In so holding, the Court declared it to be a purpose of our system of justice to ". . . prevent even the probability of unfairness." In disapproving the disputed dual function of the trial judge, the Court noted that:

> ". . . the judge, whom due process requires to be impartial in weighing the evidence presented before him, called on his own personal knowledge and impression of what had occurred in the grand jury room and his judgment was based in part on this impression, the accuracy of which could not be tested by adequate cross-examination." 349 U.S. at 138.

It cannot be doubted that Judge MacMahon is a witness

to a material fact in this case within the meaning of 28 U.S.C. § 455. He can testify to the effect that: 'This is the erroneous ethics opinion. I wrote it. This is what it says . . . . This is the reason why I was called upon to write it . . . . This is what I meant when I wrote it. . . . This is the extent of the opinion's impact upon Goldberg's professional standing. . . .' To be such a witness does not require that a judge be an actual or essential testifying witness. Indeed, the Federal Rules of Evidence absolutely preclude a trial judge from appearing as a testifying witness (Rule 605), and it would concededly be possible and indeed preferable to present the case without summoning Judge MacMahon to the stand. But it is respectfully submitted that the statute's prohibition is founded upon more subtle and fundamental considerations than the mere prevention of trials in which the testimony of an essential witness is precluded because he happens to be the trial judge. As the cases demonstrate, the purpose of the statute's prohibition of the witness-judge is essentially threefold: 1) to prevent a judge from basing factual*/ (and legal) rulings upon fact sources (his own perceptions and recollections) which do not appear in the record; 2) to prevent the appearance of an unfair advantage on the part of the trial judge in the eyes of the jury, which results from the witness-judge's being

---

*/ Of course, unless trial by jury, as Goldberg has demanded, is waived, the Court below will not be called upon to render ultimate findings of fact. Nonetheless, the Court frequently makes factual evaluations in connection with legal rulings which it makes. See, e.g., Fed. Rules of Evidence Rule 104(a).

able to declare or intimate in his rulings: "I know the truth. I was there."; and 3) to avoid situations in which the jury, when called upon to make fact findings, is placed in a position of second guessing whether its findings are consistent with the judge's perceptions and with what his testimony might have been.

In light of Judge MacMahon's status as a "witness" to material facts and in view of the dangers to the appearance of justice which are outlined in support of this appeal, Goldberg submits that Judge MacMahon's refusal to recuse himself constituted an abuse of discretion, which abuse is further highlighted by the fact that there are no apparent offsetting ". . . considerations of efficient judicial administration which favor his presiding" (United States v. Halley, supra) to justify the denial of recusal.

CONCLUSION

For the foregoing reasons, it is respectfully requested that the order of the Court below requiring that Goldberg try his claims, if at all, in state courts be reversed and the case remanded for trial, and that the order of the Court below refusing to disqualify itself be reversed and the case assigned to another judge for trial.

Respectfully submitted,

THAL & YOUTT
Attorneys for Appellant

919 Third Avenue
New York, New York 10022
[212] 751-3300

Of Counsel:
Harry E. Youtt
Michel L. Stone

APPENDIX OF PRINCIPAL STATUTORY AUTHORITIES

28 U.S.C. § 455:

Interest of justice or judge

Any justice or judge of the United States shall disqualify himself in any case in which he has a substantial interest, has been of counsel, is or has been a material witness, or is so related to or connected with any party or his attorney as to render it improper, in his opinion, for him to sit on the trial, appeal, or other proceeding therein.

28 U.S.C. § 1331(a):

Federal question; amount in controversy; costs

(a) The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States.

Federal Rules of Civil Procedure, Rule 13(a):

Counterclaim and Cross-Claim

(a) Compulsory Counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction. But the pleader need

not state the claim if (1) at the time the action was commenced the claim was the subject of another pending action, or (2) the opposing party brought suit upon his claim by attachment or other process by which the court did not acquire jurisdiction to render a personal judgment on that claim, and the pleader is not stating any counterclaim under this Rule 13.

United States Court of Appeals
for the Second Circuit

HerbertFederman et al.,
Plaintiffs,
against
Empire Fire and Marine Insurance Company et al.,
Defendants-Appellees,
and
Stuart C. Goldberg and Jacob Aschkenasy,
Additional Defendants on Cross-Claims,
Stuart C. Goldberg,
Additional Defendant on Cross-Claims,
Appellant.

AFFIDAVIT OF SERVICE

STATE OF NEW YORK,
COUNTY OF NEW YORK, ss.:

Jerry N. Simmons, being duly sworn, deposes and says that he is over the age of 18 years, is not a party to the action, and resides at 40-04 Vernon Boulevard, Long Island City, New York
That on September 1, 1977, he served 2 copies of Brief and 1 copy of Appendix
on

Aranow, Brodsky, Bohlinger,
Benetar & Einhorn
469 Fifth Avenue,
New York, New York, 10017.

D'Amato, Costello & Shea,
By: Robert E. Mesnel, Esq.,
116 John Street,
New York, New York, 10038.

Davis & Davis,
116 John Street,
New York, New York, 10038.

by delivering to and leaving same with a proper person or persons in charge of the office or offices at the above address or addresses during the usual business hours of said day.

Jerry N. Simmons

Sworn to before me this
1st day of September, 1977

John V. Prescott
Notary Public, State of New York
No. 30-0932350
Qualified in Nassau County
Commission Expires March 30, 1979